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Review

Serbia and the Stability Pact:

What comes after the Thessaloniki meeting?

Miroљub Labus

After the Stability Pact Second Regional Table, held in Thessaloniki in June, the united Serbian opposition somehow surprised the participants by submitting a proposal to organize a funding conference for the reconstruction of post-Milosevic Serbia. The first political and diplomatic reaction was both positive and encouraging. The messages were also very clear. The commitment of the opposition parties to pursue the struggle for changing the regime through elections and to become as united as possible was welcomed. The question of the Serbian Renewal Movement's absence was raised, but that missing signature, contrary to previous cases, did not condition the initiative. Signatories of the proposal are expected to produce a short and clear political document so as to state precisely their electoral demands and set out the position of a future government towards Europe. Their position in the submitted proposal is interpreted as an important part of that platform.

With this project the Serbian opposition stands both to gain and lose a lot. If the project is successfully accomplished, it will dramatically increase confidence in the opposition's ability to govern the country in the future and to carry out the necessary reforms. Undecided voters would react positively.

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FRY Basic Economic Indicators	1999. 1998.	1999.	V 2000 IV 2000	V 2000 V 1999	V 2000 I-V 1999	I-V 2000
GDP - USD million	14,224 ^{a)}	-19.3%	...	...	...	...
Montenegro	...	...	...	...	...	...
Serbia	...	...	...	...	...	...
GDP per capita - USD	1,699 ^{a)}	-19.1%	...	...	...	...
Montenegro	...	...	...	...	...	...
Serbia	...	...	...	...	...	...
Central Serbia	...	...	...	...	...	...
Vojvodina	...	...	...	...	...	...
Industrial Production	...	-24.1%	...	3.2%	96.2%	14.9%
Montenegro	...	-7.6%	...	-15.5%	4.6%	-0.6%
Serbia	...	-25.6%	...	4.3%	106.8%	16.4%
Central Serbia	...	-24.5%	...	2.3%	101.8%	19.5%
Vojvodina	...	-28.2%	...	9.1%	118.8%	9.6%
Average Wage - DM	107	-31.7%	...	...	...	...
Montenegro	154	-14.1%	...	...	...	...
Serbia	102	-33.8%	89	1.0%	-0.3%	-30.5%
Unemployment Rate^{a)}	27.3%	8.3%	...	...	...	...
Montenegro	36.8%	7.9%	...	...	...	...
Serbia	26.5%	8.2%	...	...	...	...
Export - USD million	1,498	-46.9%	131.4	-0.9%	53.7%	2.5%
Montenegro	123	-4.7%	6.3	-50.2%	-31.7%	36.1%
Serbia	1,375	-48.9%	125.1	4.3%	64.0%	-0.3%
Import - USD million	3,296	-30.3%	266.9	-22.1%	99.9%	30.0%
Montenegro	358	6.9%	19.1	-46.6%	-27.9%	-14.0%
Serbia	2,938	-33.2%	247.9	-19.2%	131.5%	37.1%
Monetary supply (M1), end of period, DIN billion	16.4	51.9%	18.7	5.0%	47.6%	49.7%
Cash	6.7	34.0%	5.7	-10.5%	14.5%	23.6%
Deposits	9.7	67.2%	13.0	13.7%	69.2%	68.5%
Real money supply, end of period, DM million	739	-42.3%	686	3.0%	-39.8%	-42.3%
Market exchange rate, monthly level	4.25%	-38.8%	5.43%	6.1%	146.8%	-2.6%
Retail prices	...	42.4%	...	5.2%	61.5%	55.9%
Montenegro	...	60.1%	...	11.6%	151.5%	135.7%
Serbia	...	41.1%	...	4.5%	55.8%	50.4%
Cost of living	...	44.9%	...	5.7%	70.2%	64.5%
Montenegro	...	67.2%	...	10.0%	159.0%	147.9%
Serbia	...	43.5%	...	5.5%	64.0%	57.2%
Industrial prices	...	44.2%	...	5.3%	102.2%	84.3%
Montenegro	...	63.7%	...	11.2%	153.2%	139.6%
Serbia	...	43.2%	...	4.8%	98.4%	80.8%
Black market exchange rate (din/DM)	12.6	88.1%	22.7	-1.4%	113.4%	130.3%

^{a)} G17 estimate based on official information from the Federal Statistics Office

^{b)} The rate of unemployment for IV 2000 is 27.41% in Serbia, 40.16% in Montenegro, & 28.36% in FRY.

Elections as a referendum

Potential rivalry needs to be avoided

Joint working group

Virtual donors' conference

They believe that changes must come, but are not convinced in the opposition's ability to bring them about. In recent public opinion polls 70% of respondents favored changes. However, that percentage scales down to around 50% when asked whether they are for changes which will result in larger inequalities in income distribution. If the question is reformulated and changes are linked with greater opportunities for increased wages, but also with a certain increase in the risk of unemployment, the commitment for changes registers at around 40%.

This is still not the majority of the electorate, whose support is crucial for the transition of the economy and society. The donors' conference would have a substantial influence in revising this attitude, as it would reduce the risk in inevitable changes. In addition, it presumes the lifting of all sanctions immediately after a new democratic government is formed in Serbia, which also would lessen the non-commercial investment risk. The total impact on public opinion in Serbia would be more than positive.

As it appears now, the opposition will go to the next local and federal elections with two separate lists. Nobody believes that the Serbian Renewal Movement will abstain from the elections, despite its statements. Two lists for the local elections impair the opposition's prospects for remaining in power in the towns that it governs now. Thus we can understand that both the civil society in Serbia and the international community hope to see only one list - that of the united opposition. In addition, this would turn the local and federal elections into a referendum on the current regime, with great prospects that such a referendum might bring about democratic changes.

Yet, all previous requests of the international community and the civil society in Serbia for a single electoral list have failed. Such a policy has de facto given the right of veto to one political party and the possibility for countless inter-party negotiations. It has created an impression of the policy of endless waiting and futile discussions affecting the opposition's prospects to win the elections. Because of that, all opposition parties, with the exception of the Serbian Renewal Movement, have decided to begin with preparations for elections - leaving the doors open for the SPO to join them at any time. A serious debate on the proposal for the donors' conference for post-Milosevic Serbia would be a clear signal of the international community to the opposition parties and voters in Serbia: The international community wants to see a greater unity of democratic forces in Serbia and is willing to assist the citizens in the economic reconstruction. Thereby it would convey a positive message that a Serbia which shares the same values and ideals as other European countries has its place in the community of European states.

It was stated in Thessaloniki that the ministries of finance of member countries would have great reservations with respect to securing the funds before Serbia became a full-fledged member of the Stability Pact. Therefore, further bilateral talks were suggested, wherein all details of the proposal would be discussed.

G17 PLUS prepared the proposal technically, though it was formally submitted by the united Serbian opposition. It was an important new moment in the development of relations between opposition parties and civil society sectors. Before that, opposition parties were willing to cooperate only with the students' movement "Otpor" (Resistance), while cooperation with other organizations was always subject to veto by some opposition party. The change of relations between the SPO and other opposition parties has removed that impediment for cooperation.

Nevertheless, the initiative's fate should not be dependent on anybody's individual position. Experience is in favor of this solution. The Alliance for Change had good initiatives at the end of the last year, but due to disputes over the tactics of political struggle against the regime, it was impossible to draw a joint proposal on future economic cooperation between Serbia and the world. That issue has been temporarily abandoned and so has the whole body of cooperation. The proposal for the funding conference for the reconstruction of post-Milosevic Serbia revives this idea. What should be avoided now is a potential rivalry between the opposition and non-governmental sector. We believe that past experience will prevent us from making the same mistake this time.

The proposal to organize a funding conference for the reconstruction of post-Milosevic Serbia does not relate to all three working tables, but to Working Table II exclusively. This is a disadvantage that can be eliminated in further procedure, as some opposition parties have expressed their readiness to cooperate on the projects' evaluation in the sphere of media and education.

What are the possible follow-up actions concerning the submitted proposal? One of the possibilities is the formation of a joint working group within the Working Table II, so as to examine and report on the submitted proposal. Discussions will be held primarily among experts. After submitting the report to Working Table II a decision on the next step will be taken. Of course, it depends on the assessment of the submitted proposal's validity and a political decision about follow-up actions. As we understood, that was what Mr. Bodo Hombach, the Stability Pact Special Coordinator has decided to do.

The other possibility, which does not exclude the first one, is that the EU will establish a working group consisting of its own and Serbian economists. It would have a broader task concerning all issues of the economic situation in Serbia. The working group would submit a proposal to the EU on the specific assistance to the future democratic government in Serbia. This could be a completely anticipated step as the EU has already expressed its intention to support financially the integration of democratic Serbia into its political and economic institutions.

Relative to the essence of the proposal, there are also two options. One is to proceed with talks on a post-Milosevic funding conference. This type of conference is also called a "Virtual Donors' conference". The second option is to initiate real preparations for a preparatory donors' Conference". Potential donors and investors would not "sign the checks" in advance for the chosen projects, but rather they would examine in detail the submitted proposals and select those intended for support. Each of the selected projects presumes a certain financial support and time for realization. After free and fair elections are held in Serbia and a reformist government is formed, the real donors' conference could be held in the shortest possible term.

The experience of the conference in Brussels and the events afterwards should be used in this case as well. That conference could be briefly presented as follows:

Political support => Finance => Project evaluation => Implementation

Some "quick start" projects were not realized so quickly but will be initiated in the next 12 months. The reason is that they were not completed at the moment of adoption, so they could not be realized immediately. In the case of Serbia, the technical evaluation of projects should start immediately so as to save time. Therefore, the sequence of steps could be as follows:

Political support => Projects evaluation => Finance => Implementation

Given the potential danger of social turmoil after the change of regime in Serbia, it is very important that the intended international support comes in time. Thus, preparatory work for such support should begin as soon as possible.

Financial Needs for Macroeconomic Reforms and the Reconstruction of Serbia

Macroeconomic reforms and the reconstruction of Serbia contributing to its return into the international community are difficult tasks which a newly elected democratic government will be unable to accomplish unless it obtains strong domestic and international support as early as in the first month of its mandate. In order to secure an increased living standard of the population on a permanent basis and to justify the great expectations of citizens after the change of authoritarian regime, the new government will have to start immediately with radical economic reforms. This presumes primarily a monetary reform, the initiation of fiscal reform and the realization of a program of swift privatization, with a significant increase in the level of education, health-care and social security for the population.

Taking into account the horrendous economic and social consequences of the former Yugoslavia's disintegration, civil war, and the ill-conducted economic policy of the current regime, as well as international sanctions, the country's isolation and NATO bombing campaign it is quite obvious that the new government would be unable to finance alone the conduct of economic reforms and the reconstruction of domestic infrastructure, even if it succeeds in engaging all available resources. On the other hand, even under the most favorable conditions, the renewal of Serbian membership in international financial institutions (the IMF, the World Bank), and a solution to the issue of succession with former Yugoslav republics would take several months, which is enough for the new government to lose its credibility and face serious social dissatisfaction among its citizens. This would impede its activities and could result in public calls for the abandonment of reforms. The new government, therefore, has to have a relevant foreign assistance at its disposal in the very beginning of its mandate. Such assistance could be secured only by donations within the Stability Pact for SouthEast Europe. Part of the assistance would be earmarked to a fund for macroeconomic stabilization, while the rest would be invested into the reconstruction and modernization of infrastructure.

I. Financial Assistance for Macroeconomic Stabilization

Coverage from real sources of public sector deficits in Serbia during the first year of the new democratic government would ensure:

- non-inflationary financing of public expenditures and macroeconomic stability of the economy,
- positive impact on economic growth,
- reform of the whole fiscal system and, in particular, the introduction of transparent mechanisms for collecting fiscal revenues and public spending.

Meanwhile, this would imply definite international community support to the new democratic government and its orientation towards political and economic reforms in the country.

Financing

The public deficit in 2001 is forecasted to be USD 942 million, accounting for 6.9% of the NMP. This deficit could be partially financed from domestic resources. On the basis of the quick sale of parts of domestic companies (state and socially owned) currently undergoing privatization it would be possible to collect around USD 350 million. The remaining USD 600 million should be financed from external sources. As the country's credit worthiness will be low, it is unlikely that more than USD 100 million can be obtained on the European capital market. Around half a billion dollars should be collected through the Fund for macroeconomic stabilization, which would be formed within the Stability Pact for SouthEast Europe.

Financial Assistance for Macroeconomic Stabilization

Financial sources	Amounts in million dollars
Privatization proceeds	350
Short-term credits	100
Stability Pact's Fund for macroeconomic stabilization	500

Stabilization of domestic currency

Finances for the Fund for macroeconomic stabilization would be employed to bridge budgetary gaps, but also for domestic currency stabilization. The Fund's revenues would be used for the increase of foreign currency reserves held by the National Bank of Yugoslavia, on the basis of which it would be possible to issue a new domestic convertible currency, by adopting some of the floating rate modalities. For a sustainable backing of the exchange rate, a relatively modest level of foreign currency reserves would be required in the beginning, despite the fact that real money supply (M1) only stood at around USD 330 million in the middle of 2000. It should be taken into account that an important part of financial transactions in Serbia is being conducted in the zone of the shadow economy (at least 50%) and that its share would be gradually integrated into the formal sector, through the conduct of fiscal reforms. This will additionally increase official reserves.

Suspension of off-budget revenues and expenditures

The introduction of off-budget revenues coincides with the reduction of the registered fiscal deficit. Hence, there is a reasonable doubt that the existence of off-budget revenues and expenditures raises the real public deficit, the scope of which has, officially, been declining over the last three years from 12.8% to 9.1% of NMP. In 2001, fiscal transparency will be introduced. All off-budget payments will be suspended, while off-budget revenues will be included in the budget. This will result in a reduction of the registered fiscal deficit to 6.9% in 2001.

In the previous years, a quasi-fiscal deficit (losses of public enterprises) accounted for between a half and two-thirds of the total deficit. In 2001, we anticipate price liberalization, privatization and the beginning of public enterprises' restructuring. The quasi-fiscal deficit will be drastically reduced (even perhaps completely annulled), but, consequently, part of the budget assets intended for social protection and unemployment benefits, i.e. re-qualification and productive employment of labor surplus would have to be increased. This will result in upward pressure on budgetary deficits in the medium-term.

Immediate financial assistance

The Stability Pact is Key

Structural reforms will bring fiscal transparency and budget deficits

Military and police expenditures will fall

Social expenditures will rise

Targeted quick privatization would ease some of the burden

Relative to 1997, fiscal revenues would be reduced by 1.5%, while fiscal expenditures would fall by 1% of NMP. Nevertheless, they will still remain high, accounting for 53% and 59.9% of NMP respectively. A further decrease of their share of NMP is possible only with faster economic growth.

Demilitarization

Military expenses will be reduced from the present 7% to 5% of NMP. This was the limit determined by law, even before the breakup of the former Yugoslavia. Further estimates of military expenditures will depend on the country's defense strategy, which the new Parliament must adopt. Police expenditures will be drastically scaled down to 1.3% of NMP, as a reduction of police forces and the removal of the reasons for its "special purposes" (due to which such expenditures have significantly grown in the last two years) are also envisaged.

Estimates of the Fiscal Deficit

	Public expenditures in Serbia ¹							
	1997	1998	1999	2001	1997	1998	1999	2001
	In million dollars				Shares in Net Material Product			
Defense	853	771	754	679	6.2%	5.4%	7.0%	5.0%
Administration	212	211	180	204	1.5%	1.5%	1.7%	1.5%
Police	399	522	408	173	2.9%	3.6%	3.8%	1.3%
Judiciary	127	100	78	272	0.9%	0.7%	0.7%	2.0%
Education	812	604	478	883	5.9%	4.2%	4.4%	6.5%
Social Protection	306	357	220	408	2.2%	2.5%	2.0%	3.0%
Investment	142	135	102	136	1.0%	0.9%	0.9%	1.0%
Pension	2,661	2,722	2,018	2,446	19.3%	19.0%	18.6%	18.0%
Health Care	1,400	1,164	978	1,359	10.2%	8.1%	9.0%	10.0%
Labor Market	97	95	80	340	0.7%	0.7%	0.7%	2.5%
Local Governments	799	843	620	815	5.8%	5.9%	5.7%	6.0%
Debt Service				158				1.2%
Others	567	424	328	272	4.1%	3.0%	3.0%	2.0%
Total Expenditures	8,375	7,948	6,244	8,144	60.9%	55.6%	57.6%	59.9%
Total Revenues	7,493	7,444	5,940	7,201	54.5%	52.0%	54.8%	53.0%
Deficit	-882	-504	-304	-942	-6.4%	-3.6%	-2.8%	-6.9%
Net Material Product	13,758	14,304	10,835	13,587				

¹ The Republic of Serbia without Kosovo

Social expenditures

Pension expenditures are the largest problem of public financing. Reduction in their share of NMP by one percent of its three-year average is predicted. This would provide for a modest pension increase relative to those paid in 1999, but it would still remain below the level of 1997. Further reduction of expenditures for pensions is related to a serious pension system reform.

Education and health care expenditures would be returned to the level of 1997, meaning that economic growth would require an increase in the share of education expenses by at least a half percent of NMP.

Expenditures for social safety and the labor market will be increased by one and two percent of NMP respectively due to demilitarization needs, employment, and re-qualification of redundancies resulting from the restructuring of public enterprises and the liberalization of their prices.

The introduction of an independent judiciary and anti-corruption struggle require an increase of expenditures to support the legal state. Due to the limited maneuvering space, an increase of these expenditures by only one per cent of NMP is predicted.

External debt servicing

In 2001, the beginning of regular external debt servicing is predicted. If commitments for external debt servicing from the Memorandum signed with the London Club of Creditors in 1998 and legal commitments on citizens' frozen foreign currency savings were undertaken, budgetary obligation on these bases would account for 1.2% of NMP.

Privatization proceeds

In 2001, it would not be realistic to expect a quick inflow of foreign capital on the basis of privatization of domestic enterprises. Maximal proceeds of USD 350 million could be expected. Candidates for quick privatization are cement and tobacco factories, Yugoslav Airlines, the oil refinery in Novi Sad, a part of the chemical industry, and distributional elements of the power utilities and the oil industry.

In the case of a lower NMP growth or adjustment of electricity prices over a longer period of time (for example, within three years), the forecasted public deficit in 2001 could be much higher. On the other hand, it is possible that revenues for covering the fiscal deficit are not realized as planned. For example, it is possible that the sale of enterprises does not go as fast as expected or that the financial market does not accept state securities in the planned scope. In that case, larger financial support for the stabilization of the Serbian economy in the first year of the new democratic government should be considered.

Speedy recovery of the economy

Following the conflict with NATO, we anticipate a speedy recovery of the economy that will significantly mitigate the problem of public deficit. The expected growth rates of the NMP in this and the next year are 14% and 10% respectively. However, in 2001, the NMP will fail to reach the level it had in 1998. Therefore, the low level of the NMP still presents the greatest obstacle for balancing public revenues and expenditures.

II. Reconstruction and Modernization of Infrastructure

For over two decades the macroeconomic development of Serbia has not favored investments in infrastructure. In the 1980's, NMP stagnation produced delay and, in some cases, abandonment of needed infrastructure projects. In the 1990's, a deep-rooted economic crisis in Serbia placed infrastructure in a very hard position. There were no new infrastructure projects and the existing infrastructure systems were not properly maintained. The overall situation was aggravated with the physical destruction of elements of infrastructure in the spring of 1999, as a result of the NATO campaign.

Investments in Serbia's infrastructure are a necessary component of its future development. The projects we presented are part of the complex studies of urban rehabilitation of Serbian towns, which will prepare a basis for the necessary conversion of industry to a higher stage of urban development (the stage of regional towns).

Types of infrastructure projects

There are three types of infrastructure projects:

- (1) projects of national importance (investments into the international road and railroad network, reconstruction of bridges, revitalization of the power industry, reconstruction of the main oil and gas pipelines network);
- (2) projects of regional importance (clearance and maintenance of waterways /the Danube/; flood prevention; rehabilitation of irrigation and drainage channels in Vojvodina; reconstruction of the Rzav accumulation /water supply/);
- (3) projects of local importance (investments into vital infrastructure projects in 13 Serbian municipalities).

Financing

Finances required for the realization of infrastructure projects of national, regional and local importance amount to around USD 6.8 billion. This sum is the product of preliminary assessments of needs for investments into Serbia's infrastructure. Depending on investment areas, the needs refer to the period between 3 years (power industry) and 10 years (traffic). Financing of the large infrastructure projects from domestic resources will not be possible given the poor economic situation of the country. Thus, in the very beginning of economic reforms, the majority of funds needed for the infrastructure financing should be secured through donations or loans by European banks, primarily the European Investment Bank. In a later stage, infrastructure projects would be financed from foreign direct investments and concessions.

Stages

The large scope of investments in infrastructure and the relatively long period for their realization requires that the investments be divided into relevant time stages. In the first year of the new government's mandate, the realization of quick start projects would begin: reconstruction of main roads on Corridor X, rehabilitation of destroyed power capacities, and reconstruction of new facilities in the transmission network and open cast mines, clearance of the Danube, revitalization of the Dunav-Tisa-Dunav irrigation channels and realization of the urban infrastructure projects at the local level.

Mutual Interests

SouthEast Europe is away from the main European markets and presents a European periphery in economic terms. Investments in Serbia's infrastructure, particularly in significant transport corridors, would enable mutual connections with the countries in the region and connections with the markets of developed European countries and MiddleEast countries. Energy infrastructure would gain characteristics of a regional market (power industry) or would become important for oil and gas transit. Infrastructure development would provide stabilization of the entire region, thus making it a significant market for European manufacturers.

Completion of a traffic network, particularly the Corridor X, would provide for a significant increase of foreign currency revenues. Given that Serbia will have serious difficulties to finance its external debt in the years to come, this inflow of hard currencies will have substantial positive effects on the balance of payments and the whole development of the country.

Due to the nature of infrastructure, donations, loans, concessions and FDI in this area will have long-term effects in Serbia. These effects have at least two features. The new infrastructure facilities built from international sources will be in operation for a number of years, thus remaining as a corner stone for future development. Also, services from these facilities will be available in the long-term and a large number of people will benefit from them. The donations, loans, concessions and FDI would serve not only the present generation and immediate purposes, but also future generations and the needs of Serbia and regional countries.

**Two decades
of decay**

**Domestic financing
will not be
sufficient**

**The entire region
benefits**

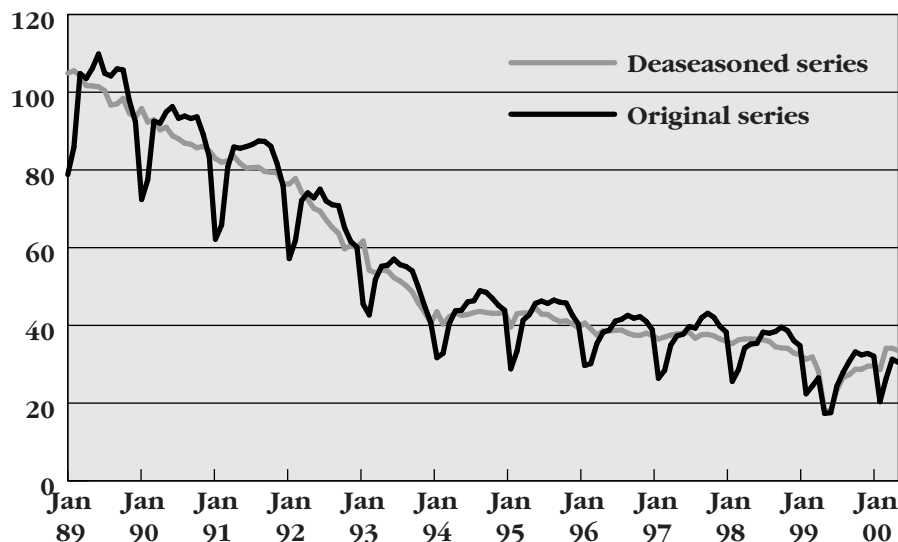
*Investment Requirements and
Financial Sources*

Projects	Amounts (USD mil.)	Quick start	Second stage	Donation (D), Loan (L), FDI, Concession (C)
Main roads	3,113	200	2,913	D, L, C
Railroads	600	30	570	D, L
Power Industry	2,133	231	1,902	D, L, FDI
Gas pipelines	350	50	300	L, FDI
Oil pipelines	35		35	L, FDI
Regional projects	524	67	457	D, L
Local projects	57	57		D, C
Total	6,812	635	6,177	

MACROECONOMIC REVIEW

Living costs in Serbia rose by 5.5% • Industrial production rose by 3.2% • Does the multiplier function? • The next months' open monetary policy issues

*Indices of effective working hours in FRY civil engineering
(1989 average = 100)*



Prices

The month of May in Serbia recorded retail price growth of 4.5%, and 11.6% in Montenegro. It is evident that the change of the foreign currency exchange rate in accounting imported consumer goods has not yet fully reflected upon retail prices, its effect remains to be seen in the months to come. The items recording the largest price growth were: personal hygiene up by 7.7%, fresh fruit up by 16.9%, and fresh vegetables up by 21.1%.

According to official statistics, since the beginning of the year prices in Serbia rose by 13.1%, and by 31.8% in Montenegro.

The cost of living in Serbia was up 5.5% in the month of May, slightly more than the growth of retail prices, while in Montenegro the cost of living rose by 10.0%, somewhat less than retail price growth.

The larger growth of producer prices in May relative to April announces larger retail price growth in June. The largest growth (at FRY level) was recorded in construction material production - as much as 87.8%.

Industrial production

Industrial production in the FRY increased by 3.2% in May month-on-month. In Montenegro, production fell by 15.5%, while in Serbia it rose by 4.3%. Production growth in central Serbia amounted to 2.3%, and 9.1% in Vojvodina. Production fell in ten fields - ranging from 0.7% (production of traffic means) to 34.5% (shipbuilding), while it increased in all other fields, ranging from 0.2% (electric machine and appliances' production) to 43.4% (oil derivatives' production). The deseasoned index for May shows a rise relative to April of 0.7%, meaning that production remained practically on the same level.

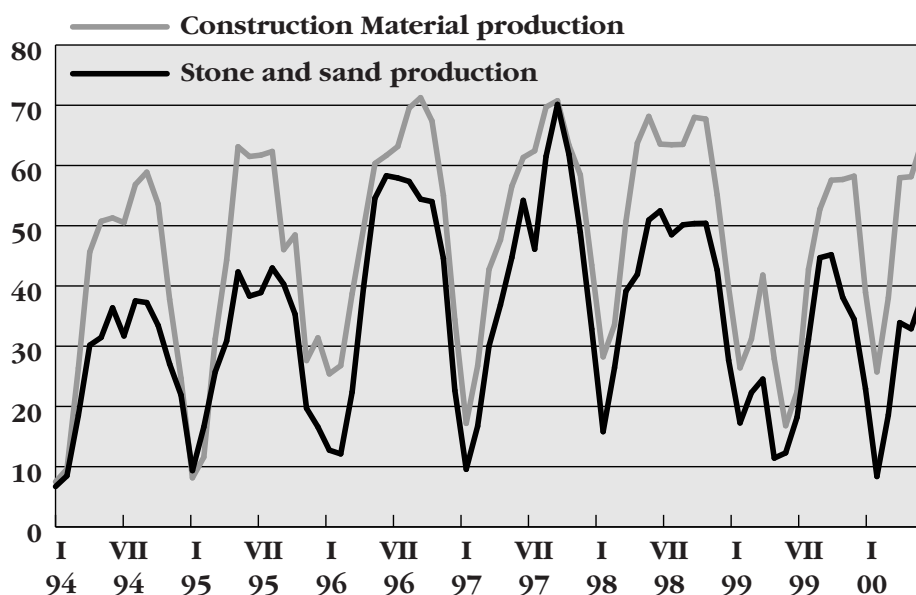
In May industrial production in FRY was up 962% year on year. The same seasonal factors were at work then, but so were the NATO bombing forces, so that such large growth resulted primarily from the very low base from which it was calculated. Industrial production in Montenegro was up by 4.6% year on year, and up by 106.8% year on year in Serbia. Industrial production increased by 101.8% and 118.8% year on year in Central Serbia and Vojvodina, respectively.

Industrial production in FRY during the first five months of year 2000 grew by 14.9% relative to the same period last year. In this case the figures show real production growth. However, similar to the

case of the index for May 2000 to May 1999, growth figures result from last year's low base. A fall of 0.6% was recorded in Montenegro, while there was growth of 16.4% in Serbia. Production in central Serbia increased by 19.5%, and 9.6% in Vojvodina.

The country's reconstruction started off with a conviction that the multiplier will function and lead to a significant increase in GDP. The multiplier effect exists, but to a lesser degree than anticipated. In the previous month, Group 17 tried to evaluate the total of reconstructed facilities. A document entitled "Serbia 2000" operated with a figure of 191.3 million USD. It appears that official statistical data on production trends speak in favor of this estimate, especially in fields related to reconstruction, as well as civil engineering trends. It is interesting to note that levels recorded in the mentioned industries, or sectors, are lesser than levels achieved in 1998, which is not in compliance with the general image of reconstruction. If we took notice of the import of goods needed for reconstruction works, we would see, for example, that only a few of them are among the first one hundred items, which is logical with regard to displayed import tendencies.

*Indices of stone and sand and construction material production in FRY
(1989 = 100)*



The fact that industrial production in the FRY was 70.0% less in May 2000 as compared to May 1989 is a logical consequence, just as it was 69.8% lesser in the January - May 2000 period relative to the same period in 1989.

Recently announced poor agricultural yields, combined with insufficiently recovered industrial production, will require corrections of the GDP estimate in the coming months.

Foreign trade and the foreign currency exchange rate

Although it is still early to speak of the effects of measures taken in the previous month, the impression emerges that the prognosis stated in the last issue of the Economic Review was accurate. The graph illustrates very well one of the key problems - the unfavorable structure of import as a direct consequence of an inadequate foreign trade policy. The second problem is, certainly, the exceedingly low level of export. In the first five months of this year exports from Serbia fell by 0.3% relative to the same period last year. In the same period imports increased by 37.1%, generating a January to May trade deficit of 843.4 million USD. Expectations of significant improvements in the situation and an increase of export revenue are unrealistic, where restrictions from abroad are viewed as a fundamental cause.

The most apparent effect is the maintenance of stability in the foreign currency market during the past month. Stability represents, in the greatest extent, a reflection of decreased demand for foreign currency as influenced by decreased import.

There is a noticeable import of merchandise by "privileged" importers that have now been classified into May and former months as a result of the customs' rate increase - the goods were taxed before the increase although they were being imported since the beginning of the year. This happened with natural gas whose import in March and April amounted to 70 million USD, and crude oil in the amount of 21 million USD.

In Montenegro exports rose in January to May by 36.1% relative to the same period last year, while imports fell by 14% and the foreign trade deficit reached 74 million USD. The considerable fall in comparison to April is a consequence of a subsequent inclusion of goods transported by sea, i.e. the true figure for May will be known at the beginning of July. Half of Montenegrin imports come from European Union countries, and they mostly consist of fuel, food, telecommunication appliances, etc. On the other hand, the relative fall of exports from Serbia to Montenegro continues.

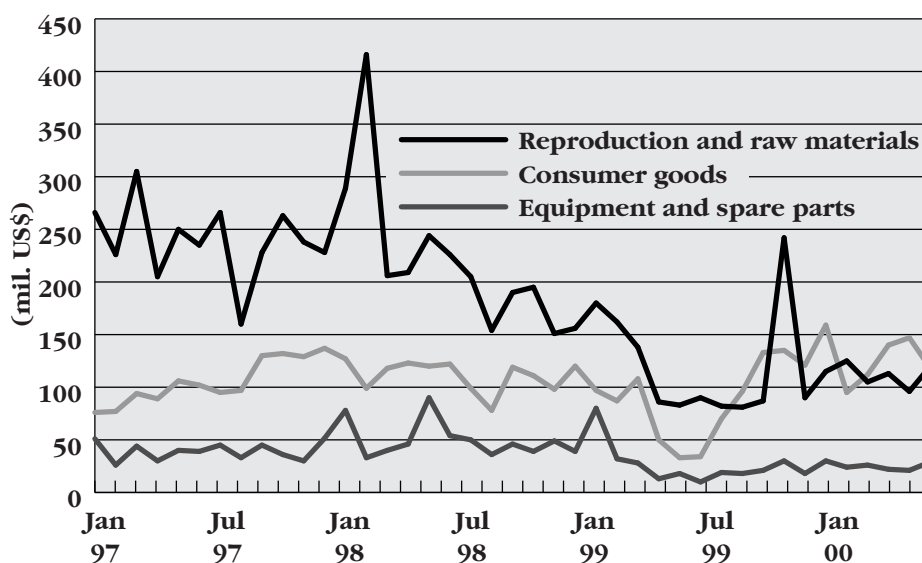
Monetary policy

According to Yugoslav Banking Association data, in the period from June 5th-29th around 15% of obligations, or around 25 million DEM, were settled from a total amount of 183 million DEM that must be settled in the course of this year. Thus, annual obligations towards around 170,000 savings accounts have been regulated. Clients face three options: they can wait for foreign currency, receive dinar payments by the "stimulative" exchange rate, or accept gold.

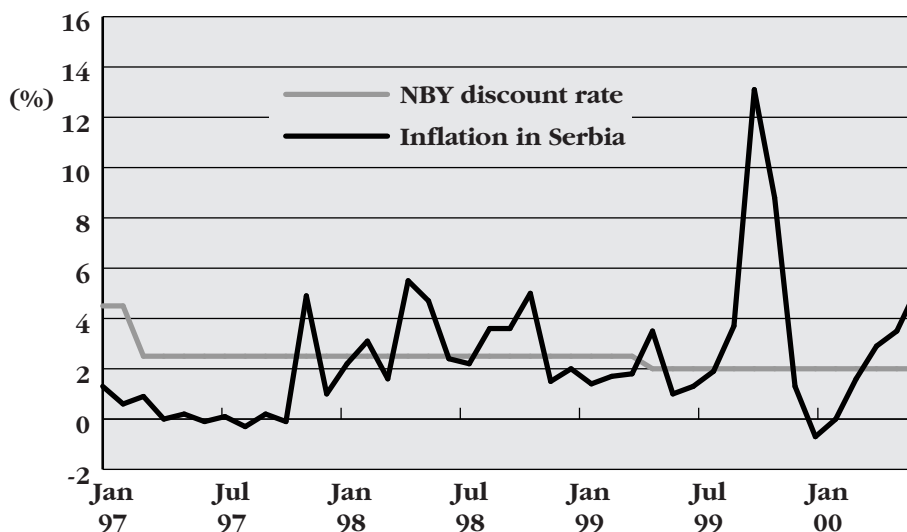
How realistic is the promise of paying off deposits in foreign currency? It is realistic to expect up to 75 million DEM until the end of the year from export proceeds. Another 25-30 million could be settled by gold coins. According to this optimistic prognosis, 100-110 million DEM in obligations would be regulated in this way. The remaining fifty million DEM or one billion dinars will need to be financed in another way.

Under these circumstances the issue arises over the kind of monetary policy that the National Bank of Yugoslavia will undertake. In the period ahead of us an expansive monetary policy would somewhat contribute to larger growth rates. On the other hand, having in mind repressed inflation and outstanding inflationary expectations, the risk would be too high. The buying up of agricultural items and the mentioned portion of foreign currency deposits, as well as the forthcoming elections, represent additional pressure, where the NBY itself has problems with monetary policy instruments - the real discount rate is negative, along with the existing problem of utilizing the reserves of commercial banks.

Imports according to customs' declaration

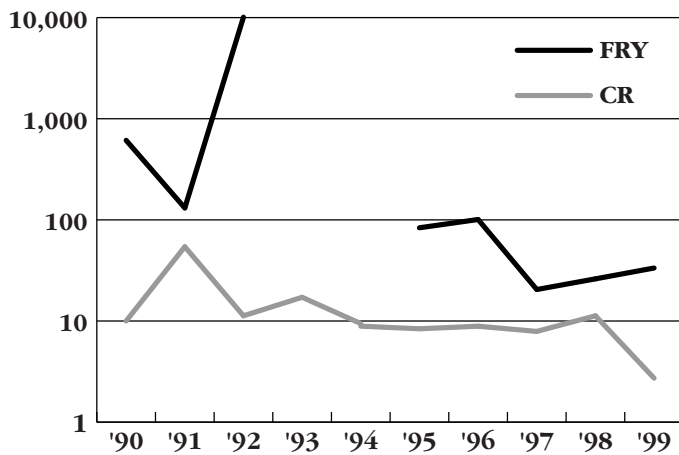


Monthly inflation in Serbia and the NBY discount rate

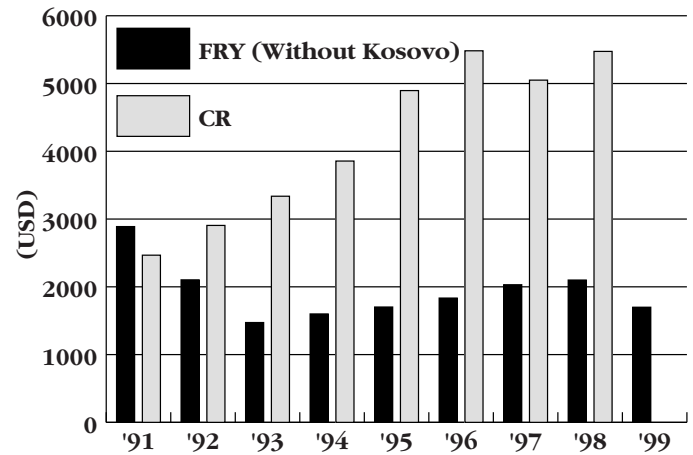


Yugoslavia in the mirror of Eastern Europe

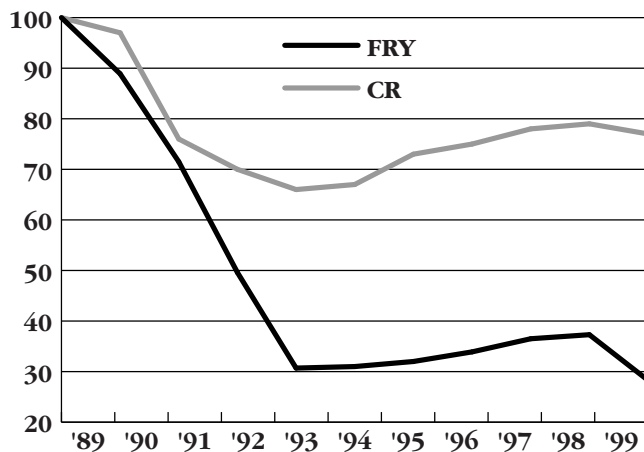
Annual Rate of Inflation



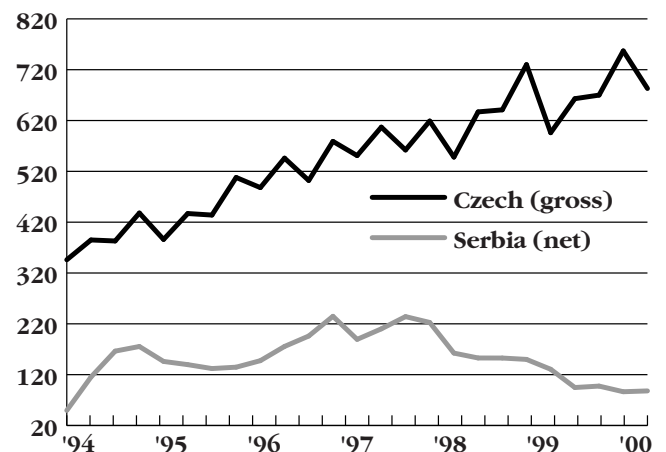
GDP per capita



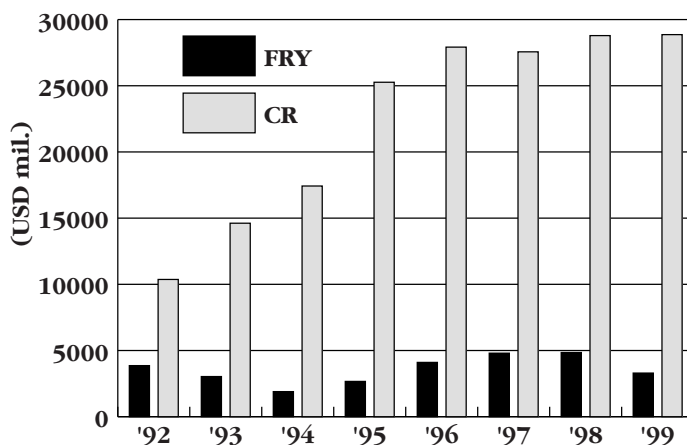
*Industrial Production
1989 = 100*



*Average Wage
(in DEM)*



Import



Export

